Good MornING Asia - 28 February 2020

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EM space: Economic data starting to reflect Covid-19 impact

General Asia: While the Covid-19 fears continued to wreak havoc in the US markets, the economic releases this morning from Japan and Korea started to reflect the damage from the virus – all this setting the trading week in Asia for a dismal end. Due over this weekend, China's purchasing manager index and Korea's trade figures for February should provide a better reading of the impact of the virus on these economies.

Malaysia: Even as the political deadlock continues, the interim prime minister Mahathir Mohamad yesterday announced an MYR 20 billion (about 1.3% of 2019 GDP) support package for sectors affected by Covid-19. But, the implementation remains up in the air with no government in place just yet. The King was unable to decide on the majority backing for one of two camps, Mahathir's and Anwar's, vying to form the next government. The Parliament is convened on next Monday (2 March) to end the standoff. Meanwhile, the MYR continued to recover losses incurred at the height of the political drama earlier this week.

Thailand: January balance of payments data today is expected to show a sharp narrowing in the current surplus judging from the worst customs-basis trade deficit in almost a year and a slump in tourism revenue due to Covid-19 outbreak. We estimate a current surplus of $1.1 billion in the last month, far below $3 billion consensus estimate. THB is re-pricing for narrowing current surplus, which we see dwindling to 3.5% of GDP in 2020 from 6.9% in 2019.

Philippines: Bangko Sentral ng Pilipinas (BSP) Governor Diokno struck a dovish tone on Thursday, hinting at additional policy easing given concerns about the economic impact from Covid-19. Diokno had previously pledged a total of 50 basis point of rate cuts but has now expressed willingness to do more policy rate cuts if needed, as well as resort to additional reductions to reserve requirements (RR). We have pencilled in a BSP rate cut in 2Q and a RR cut by 3Q.

What to look out for: China PMI and Covid-19 developments

- EU CPI (28 February)
- India GDP (28 February)
- Thailand balance of payment (28 February)
- US personal income and spending (28 February)
- China PMI (29 February)
- Korea trade (1 March)

Asia week ahead: Covid-19 disrupts most things in China

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Source: Shutterstock

Covid-19 destabilises everything

The Covid-19 is destabilising many things in China, including the most significant annual rite of spring - the National People's Congress, which usually takes place between 5 - 15 March. This is the platform the Communist party uses to announce economic targets and policies for the year. As things stand, the event will not begin next week and for now, no date has been pencilled for the future. What matters the most right now is reducing economic damage from the virus.

Talking about damage, we should be able to begin to gauge the extent from China's purchasing manager index (PMI) due on 29 February, and the Caixin measure out next Monday. A prolonged shutdown of factories for most of February spells the worst for manufacturing, and services as most of these like logistics and transports are driven by manufacturing.

… and elsewhere in Asia

Lots of PMI data from the region is due next week, and are likely to follow in the footsteps of China, however hard data like trade, inflation, retail sales will be more significant than soft data and there are plenty of those in the pipeline next week.

We will have first two months' of trade data from Korea providing a sense of a toll the disease has taken on the economy so far. China absorbs one-fourth of Korea's total exports and that market has been virtually shut since the New Year holiday in January. As such the consensus median of about 3% export growth in February sounds a little too optimistic. We expect around 3% fall.

The first thing to take a beating from an epidemic is consumption. Hong Kong's retail sales data and a slew of consumer price inflation figures elsewhere will be worth watching in this respect. Besides weak spending, the lower oil price will be weighing down consumer price inflation around the region. Korea, Taiwan, Indonesia, Philippines and Thailand will release CPI data for February.

Malaysian central bank to ease again

Low inflation keeps doors open for central bank policy easing to support growth. Central banks of Australia and Malaysia are deciding their policies next week. We expect Australia's central bank to leave policy on hold.

There will be more interest in Malaysia's central bank meeting given prime minister Mahathir's sudden resignation earlier this week, leaving the Bank to do more heavy-lifting to soften the economic impact of the virus. While there isn't much fiscal policy leeway for the government, Mahathir, who's currently interim prime minister, went ahead to announce an MYR 20 billion (about 1.3% of 2019 GDP) support package for sectors affected by the virus.

But, the implementation remains up in the air with no government in place just yet. Hence our forecast of a 25 basis point cut to 2.50% - the second easing move by BNM this year.

Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
		Saturday 29 February			
China	0100	Feb Manufacturing PMI	46.0	45.1	50
	0100	Feb Non-manufacturing PMI	52.0	51.5	54.1
		Sunday 1 March			
South Korea	0000	Feb Imports (YoY%)	5.6	-3.6	-5.4
	0000	Feb Exports (YoY%)	-3.2	4.3	-6.3
	0000	Feb Trade balance (US$mn)	500	1300	535
		Monday 2 March			
China	0145	Feb Caixin Manufacturing PMI	46.5	47.0	51.1
India	0500	Feb Nikkei Manufacturing PMI	-	-	55.3
Hong Kong	0830	Jan Retail sales value (YoY%)	-12.2	-	-19.4
	0830	Jan Retail sales volume (YoY%)	-12.1	-	-21
Indonesia	0400	Feb CPI core (YoY%)	-	-	2.9
	0400	Feb CPI (YoY%)	2.9	-	2.7
Philippines	0030	Feb Nikkei Manufacturing PMI	51.2	-	52.1
Taiwan	0030	Feb Nikkei Manufacturing PMI	48.0	-	51.8
South Korea	0030	Feb Nikkei Manufacturing PMI	49.3	-	49.8
	2300	4Q F GDP (QoQ/YoY%)	-/-	1.2/2.2	1.2/2.2
	2300	Feb CPI total (YoY%)	1.5	-	1.5
	2300	Feb CPI core (YoY%)	0.8	-	0.9
	2300	4Q19 GDP revised (QoQ/YoY%)	1.2/2.2	-/-	1.2/2.2
		Tuesday 3 March			
Malaysia	0700	Overnight Policy Rate	2.50	2.75	2.75
Singapore	1300	Feb Purchasing Managers Index	-	-	50.3
		Wednesday 4 March			
India	0500	Feb Nikkei Services PMI	-	-	55.5
Hong Kong	0030	Feb Nikkei PMI	-	-	46.8
Malaysia	0400	Jan Exports (YoY%)	-5.2	-	2.7
	0400	Jan Imports (YoY%)	-2.9	-	0.9
MALAYSIA	0400	Jan Trade balance (RM bn)	9.1	-	12.6
		Thursday 5 March			
India	-	4Q Current account balance (US$bn)	-	-	-6.3
Korea	-	Jan Current account balance (US$bn)	3.8	-	4.3
Taiwan	-	Feb Forex reserves (US$bn)	477.0	-	479.1
Philippines	0100	Feb CPI (YoY%)	3.0	-	2.9
Thailand	0330	Feb CPI (YoY%)	0.8	-	1.1
	0330	Feb Core-CPI (YoY%)	0.5	-	0.5
		Friday 6 March			
Hong Kong	-	Feb Forex Reserves (US$bn)	-	-	445.9
Malaysia	0700	Forex reserves- Month end (US$bn)	-	-	104.3
Philippines	-	Feb Forex reserves (US$bn)	87.1	-	86.9
Indonesia	-	Feb Forex reserves (US$bn)	130.9	-	131.7
Taiwan	0800	Feb WPI (YoY%)	-0.4	-	-3.1
	0800	Feb CPI (YoY%)	-6.3	-	1.9

Source: ING, Bloomberg, *GMT

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Australia's central bank to stand pat, with a possible dovish tilt

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Source: Shutterstock

February was about stoicism

The RBA may have differed from our forecast view of a cash rate cut in February, but to be fair, Governor Philip Lowe and the rest of his rate-setting team have been some of the more considered and consistent central bankers in recent turbulent times.

Our arguments for a cut last time rested on a differing view than the consensus on the latest labour data, which despite headline strength, we felt was fairly disappointing overall. We also felt that the bushfires would take a fairly hefty chunk out of both fourth and first quarter GDP and that the resulting shortfall of growth would likely merit some offsetting policy easing. In the likely absence of any meaningful boost from fiscal policy, this left the RBA to shoulder the burden. We were also perhaps taking a more serious view of the emerging coronavirus outbreak, given that we were sitting in the middle of it.

Clearly, Phillip Lowe saw it differently. On the bushfires, he was quite outspoken about this in the US, arguing that Australian spirit was unlikely to be hit too hard and the average Australian would just "get on with it". Such stoicism is probably accurate, though we still think the GDP results will show a noticeable impact.

As far as the domestic labour data goes, well what goes up one month goes down the next. The mood has swung from positivity to disappointment, though again, we think the consensus has got the wrong end of the stick and taking the two months together, there isn't all that much going on.

How things have changed

Indeed, the main flavour of the minutes of the February meeting was one of optimism. There was talk of the phase one deal with the US on trade, and a general sense that the drags to growth in 2019 would, if not reverse in 2020, move to a more neutral setting.

Domestically, the newsflow had been somewhat mixed. The preceding labour report was generally regarded as being positive (which in our view was a controversial interpretation of some very mixed numbers) and inflation had done nothing to move closer to its target-range midpoint.

On this latter point, Lowe is clear that he sees the room for monetary policy as limited, and the discussion on the possibility for some further easing is very sensibly couched around concerns that it could do more harm than good - a lesson that seems to have eluded some Northern Hemisphere central bankers.

But things have very evidently moved on since early February. We still await confirmation of the economic damage caused by the bushfires, but in our view, although this may be confined to the first quarter, it will have been quite meaningful.

Of course, the biggest change has been in terms of the Covid-19 outbreak. Here, the news for Australia is not good.

Covid-19 cases low, exposure high

At only 23 cases at the time of writing, Australia is not raising too many eyebrows on the daily check for new covid-19 cases. That may provide a sense of calm. But even if the direct impact of the outbreak is limited (so far), the indirect impact could be very far-reaching.

In our recent look at the tourism industry in the Asia-Pacific region, Australia was one of the more affected economies in terms of the importance of tourism revenue from China to the rest of the economy.

Moreover, it will still be some time before China's industrial sector is back to full strength, and in the meantime, demand for Australia's commodity output is likely to remain weak, and prices low.

On the services side, the impact of the outbreak on exports of education to Chinese and other Asian countries could also be significant.

In short, we think the worst is yet to come.

Source: Bloomberg, ING

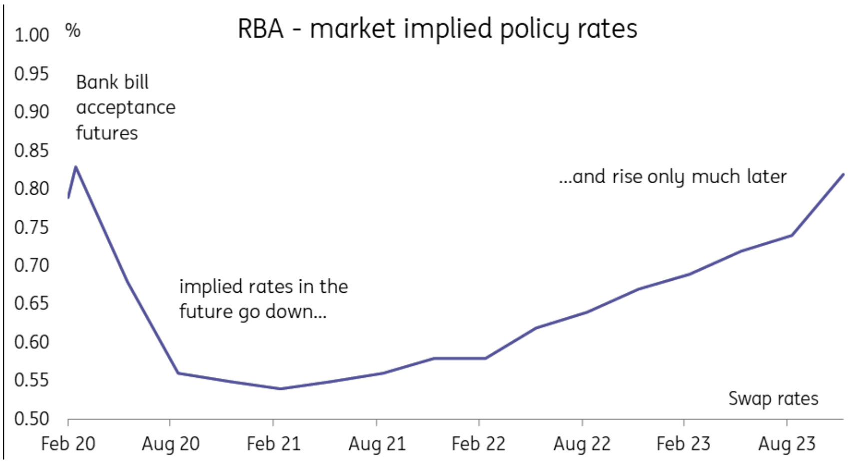
Room for easing limited

Sensibly, the RBA is clear to note that cash rates may be nearing the point where further cuts begin to do more harm to domestic demand than good - a lesson that some of their Northern Hemisphere counterparts might want to think about a little more.

Lowe has also been very clear that there is a limit to how much of the gap between the current unemployment rate and one consistent with target inflation can be met with easier monetary policy.

That's why we don't think the RBA will cut rates this month. However, we do think that the discussion will have moved on, and will now take a more downbeat assessment of the first half of the year, raising the prospects of some easing next quarter.

Bank bill futures in the last seven days have moved to price in an additional 11 basis points of easing by the end of the year. And though second quarter pricing still seems a bit hesitant, with a rate cut more obvious only by September, this leaves room for some further shift in market sentiment if the next RBA meeting provides a more sombre assessment for the economy.



Source: Bloomberg, ING

AUD: Not all negatives in the price

The Australian dollar has led losses within the G10 space over the past few days and AUD/USD has dropped by more than 4% in the spot market since the Covid-19 outbreak became public. While this may appear like a sizable loss for the currency, we think it has actually been relatively contained. A hawkish tone by the RBA in the February policy statement and broadly supportive data flow have likely curbed the currency's losses. The above-mentioned negative implications of the Covid-19 outbreak on the Australian economy and the additional downside risks stemming from the extended bushfire emergency would have probably warranted AUD/USD around the 0.64 area.

Looking ahead, how much the virus will eventually spread (or, has spread) among developed economies will determine the short-term fate for AUD, but looking at the other drivers, we note that the AUD may not find much additional support. As we have highlighted above, it will be difficult for the RBA to deliver another hawkish surprise in light of the Covid-19 outbreak, which has spread to such an extent that the number of cases outside of China now exceeds those inside the country. On the domestic side, the employment picture has remained quite mixed.

In general terms, we suspect there is a divergence between the number of downside risks to the Australian economic outlook and those embedded in the current RBA message. Governor Lowe may well retain his sanguine tone at this meeting, but the bar for a hawkish surprise seems high. We think the RBA is less likely to provide further support to the Aussie dollar and expect any AUD weakness to be mostly channelled through a lower AUD/NZD, where the monetary policy differential may be more evident (given a neutral RBNZ) than in AUD/USD (considering mounting expectations around Fed easing). We expect AUD/NZD to approach 1.03 in the coming weeks, also helped by a more aligned positioning - as highlighted in "FX Positioning: The big Kiwi short".

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Philippines: Hey big spender - December expenditures rise 58%

Despite a 5-month delay in passing the budget, the Philippines recorded a budget deficit-to-GDP ratio of 3.5%

Source: Shutterstock

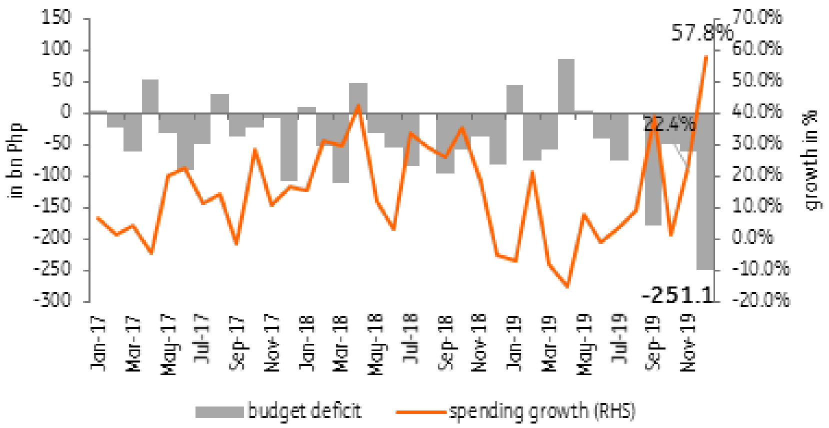
Hey big spender: December expenditures rise 58%

Vowing to make up for lost time, government expenditure posted a sizeable 58% jump for the month of December, bringing the full year deficit to Php660.2 bn for 2019. This means that the deficit moved well past the programmed target of 3.25% of GDP to hit 3.5% despite the hiccup in the first half of the year given the budget passage delay. For the year, spending rose roughly 11.4% while revenue collection growth remained healthy at 10%, highlighting that the slowdown in 2019 GDP was not due to a lack of government spending.

GDP likely to be revised higher, stimulus readied ahead of Covid-19

The strong spending to close out the year is likely to lead to an upward revision to 2019 GDP with full year growth probably realized at 6.0%. The surprise surge in spending in December is reflected in the aggressive borrowing stance of the Bureau of the Treasury (BTr) of late and we can expect this behavior to continue given the concurrent 2019 and 2020 budgets running parallel this year. With the Covid-19 virus expected to curb household spending in the coming months, we expect the fiscal front to help insulate the economy with strong spending likely to continue in 1H20. Meanwhile, monetary easing should complement the fiscal stimulus with Bankgo Sentral ng Pilipinas (BSP) Governor Diokno vowing at least 25 bp worth of rate cuts for the balance of the year to help revitalize investment momentum further.

Philippines budget deficit and government expenditure growth



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